No. 15-649

IN THE
Supreme Court of the United States

CASIMIR CZYZEWSKI, *et al.*,

Petitioners,

v.

JEVIC HOLDING CORP., *et al.*,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF IN OPPOSITION

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TABLE OF CONTENTS

Page

INTRODUCTION 1

COUNTERSTATEMENT OF THE CASE 3

A. Background 3

B. Proceedings Below 4

1. Bankruptcy Court 4

2. District Court 9

3. Third Circuit 9

REASONS FOR DENYING THE PETITION 11

I. The Circuit Split Alleged By Petitioners Is Illusory. 11

II. The Decision Below Is Correct. 16

III. This Case Is Not An Appropriate Vehicle For Addressing The Question Presented. 24

CONCLUSION 25

CORPORATE DISCLOSURE STATEMENT

Pursuant to this Court's Rule 29.6, respondents state as follows:

Respondent Sun Capital Partners, Inc. has no parent corporation and no publicly held company has a 10% or greater ownership interest.

Respondent Sun Capital Partners IV, LP, has no parent corporation and no publicly held company has a 10% or greater ownership interest.

Respondent Sun Capital Partners Management IV, LLC is wholly owned by Sun Capital Advisors IV, LP, and no publicly held company has a 10% or greater ownership interest.

Respondent The CIT Group/Business Credit, Inc. is a wholly owned subsidiary of CIT Group Inc., which is a publicly traded company. No individual shareholder holds 10% or more of the stock of CIT Group Inc.

Respondent Jevic Holding Corp. is wholly owned by Sun Transportation LLC and HIG Sun Partners, Inc., and no publicly held company holds 10% or more of its stock.

Respondent Jevic Transportation, Inc. is a wholly owned subsidiary of respondent Jevic Holding Corp., and no publicly held company holds 10% or more of its stock.

Respondent Creek Road Properties, LLC is a wholly owned subsidiary of respondent Jevic Transportation, Inc., and no publicly held company holds 10% or more of its stock.

TABLE OF AUTHORITIES

Page(s)

Cases

Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434 (1999) 16

In re AWECO, Inc., 725 F.2d 293 (5th Cir. 1984) 1-2, 12-16, 25

In re Iridium Operating LLC, 478 F.3d 452 (2d Cir. 2007) . 1-3, 10-15, 19-20, 22, 24-25

In re Jevic Holding Corp., 526 B.R. 547 (D. Del. 2014) 8

In re Martin, 91 F.3d 389 (3d Cir. 1996) 9

In re Sadler, 935 F.2d 918 (7th Cir. 1991) 24

Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414 (1968) 14, 18

Statutes and Rules

11 U.S.C. § 103(a) 17

11 U.S.C. § 105(a) 18

11 U.S.C. § 507 ..... 10, 17, 20

11 U.S.C. § 1129 17

11 U.S.C. § 1129(a) 17

11 U.S.C. § 1129(b) 9

11 U.S.C. § 1129(b)(2)(B)(ii) 16, 17, 11

29 U.S.C. § 2102 5

Fed. R. Bankr. P. 9019 ..... 7, 9, 18

INTRODUCTION

Petitioners contend that this Court should review this case because "the Second and Fifth Circuits have been at odds since at least 2007" on the question presented here, and the Third Circuit erred by siding with the Second Circuit. Pet. 18; *see generally id.* at 15-26 (citing *In re Iridium Operating LLC*, 478 F.3d 452, 464 (2d Cir. 2007), and *In re AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir. 1984)). Petitioners are wrong on all scores. *First*, the alleged circuit conflict rests on nothing more than a dated snippet of *dicta* from the Fifth Circuit. *Second*, the decision below is correct, because nothing in the Bankruptcy Code subjects *settlements* (as opposed to reorganization *plans*) to the absolute priority rule. And *third*, this case does not present an appropriate vehicle to address the alleged conflict in any event, because petitioners themselves urged the Third Circuit to adopt the Second Circuit legal standard that they now reject. Accordingly, this Court's review is unwarranted.

Even cursory examination of the Fifth Circuit's decision in *AWECO* shows that the alleged circuit conflict is illusory. In that case, which is more than thirty years old, the Fifth Circuit vacated a bankruptcy court order approving a pre-plan settlement because the bankruptcy court had "blessed the settlement without sufficient factual information to determine if the settlement was fair and equitable." 725 F.2d at 300. Accordingly, the Fifth Circuit remanded the case for the bankruptcy court to re-evaluate the settlement based on "a sufficient factual foundation." *Id.* at 299. In a single sentence of *dicta*, the court asserted that "a

bankruptcy court abuses its discretion in approving a settlement with a junior creditor unless the court concludes that priority of payment will be respected as to objecting senior creditors." *Id.* at 298.

The Second Circuit in *Iridium*, and the Third Circuit here, simply qualified that snippet of *dicta*. As those courts explained in great detail, the absolute priority rule—under which creditors are divided into classes according to the priority of their claims, and the claims of senior classes must be paid before the claims of junior classes—applies to proposed *plans*, as opposed to proposed *settlements*. To be sure, as a general rule, "compliance with the Code priorities will usually be dispositive of whether a proposed settlement is fair and equitable." Pet. App. 20a (citing *Iridium*, 478 F.3d at 455). But "usually" is not the same as "always." Deviation from the absolute priority rule may be warranted in the "rare[]" case where a bankruptcy court articulates "'specific and credible grounds to justify the deviation.'" Pet. App. 21a (quoting *Iridium*, 478 F.3d at 466), 23a. The panel below, like the Second Circuit in *Iridium*, was unanimous on this score. *See* Pet. App. 24a (Scirica, J., concurring in part and dissenting in part).

Where the majority and the partial dissent below parted company was on the *application* of the Second Circuit's *Iridium* legal standard to the facts of this case—an inherently fact- and case-specific disagreement. As the majority explained, based on the bankruptcy court's careful factual findings, the choice here was not between this settlement and *another* settlement or a confirmed plan; rather, the choice here was between this settlement and *no*

settlement or plan. This settlement was "the least bad alternative since there was 'no prospect' of a [Chapter 11] plan being confirmed," and conversion to a Chapter 7 liquidation also would have left nothing for petitioners, as secured creditors with a higher priority would have "tak[en] all that remained of the estate in short order." Pet. App. 21a (internal quotation omitted). The partial dissent's contrary view, the majority explained, "rests on the counterfactual premise that the parties could have reached an agreeable settlement that conformed to the Code priorities." *Id.*

Above and beyond the absence of any real circuit conflict, and the fact that the decision below is correct, petitioners are in no position now to contend that the Third Circuit erred by applying the legal standard articulated by the Second Circuit in *Iridium*. As the Third Circuit noted, petitioners cited *Iridium* "throughout their briefs and never quarrel[led] with" it. Pet. App. 19a. Having invited the Third Circuit to follow *Iridium*, petitioners cannot now complain that the Third Circuit accepted their invitation. At a minimum, thus, this case is an inappropriate vehicle for addressing the circuit conflict alleged by petitioners. Accordingly, this Court should deny the petition.

COUNTERSTATEMENT OF THE CASE

A. Background

Respondent Jevic Transportation, Inc. was a New Jersey trucking company. Pet. App. 2a. In 2006, after its business started to decline, Jevic was acquired by respondent Sun Capital Partners IV, LP (Sun Fund IV) in a buyout financed with a loan later refinanced by respondent The CIT Group/Business

Credit, Inc., in its capacity as Agent (CIT). *Id.* But Jevic's fortunes failed to improve, and in January 2008, the company reached a forbearance agreement with CIT—which included a $2 million guarantee by Sun Fund IV—to prevent foreclosure. *Id.*

With the advent of the Great Recession in 2008, Jevic's board of directors decided to seek bankruptcy protection. *Id.* On May 19, 2008, the company ceased substantially all operations, and its employees received termination notices. *Id.*

B. Proceedings Below

1. Bankruptcy Court

On May 20, 2008, Jevic and two affiliated companies filed voluntary Chapter 11 petitions in the U.S. Bankruptcy Court for the District of Delaware. Pet. App. 3a. At that time, Jevic owed about $53 million to CIT and Sun Fund IV and over $20 million to its tax and general unsecured creditors. *Id.*

The U.S. Trustee thereafter appointed a committee, respondent Official Committee of Unsecured Creditors, to represent Jevic's unsecured creditors. That Committee then brought a fraudulent conveyance action on behalf of the bankruptcy estates against CIT, Sun Fund IV, and two other Sun entities, respondents Sun Capital Partners Management IV, LLC and Sun Capital Partners, Inc. ("SCPI") (collectively the "Sun defendants"). *Id.*

In addition, petitioners (former Jevic employees) brought a putative class action seeking monetary damages under the Worker Adjustment and Retraining Notification Act ("WARN"), 29 U.S.C.

§ 2102, and its New Jersey state-law counterpart, which generally require employers to provide workers with 60 days' notice before termination. Pet. App. 3a. Separately, individual employees also filed claims "for unpaid wages and benefits" accrued through their date of termination. Pet. 2. Although petitioners now assert that the employees "received *nothing* for their claims," *id.* (emphasis in original), the record refutes that assertion. To the contrary, Jevic fully compensated the employees for their unpaid wages and benefits through the date of their termination—a total of $3 million. *See* Third Circuit Joint Appendix (CA3 JA), at 1262-64. The *only* claims at issue here are the classwide WARN claims for statutory damages, which petitioners brought against both Jevic and respondent SCPI (as an alleged "single employer" with Jevic).[1]

After almost four years, the parties sought to settle the fraudulent conveyance litigation and wrap up the entire bankruptcy. Pet. App. 4a. By then, the Committee was wary about continuing to litigate on behalf of the estates against well-funded adversaries because all of Jevic's tangible assets had been liquidated, and Jevic's sole remaining assets were $1.7 million in cash (subject to Sun Fund IV's lien) and the fraudulent conveyance claim. *See* CA3 JA14, 1232-35, 1253, 1277. And by then, with fees and interest, Sun Fund IV's secured claim exceeded $2.4

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[1] For this reason, *amici* National Employment Law Project (NELP) *et al.* miss the mark by talking about "wage theft—non-payment of accrued wages and benefits by employers." NELP Br. 1; *see also id.* at 7-8. As even cursory examination of the complaint reveals, the *only* claim in this putative class action is for statutory damages under federal and state WARN laws.

million, and the estates had no unencumbered assets to fund the fraudulent conveyance litigation. *See id.* at 363, 1232. Jevic had paid most post-petition administrative expenses but still owed administrative fees and expenses totaling about $1.7 million, as well as $24 million to general unsecured creditors. *See id.* at 1236.

The settlement negotiations initially involved all major economic stakeholders in the bankruptcy, including Jevic, the Committee, CIT, the Sun defendants, and petitioners. *See id.* at 28, 1237, 1240, 1274. But the parties could not agree on settlement terms that globally resolved *both* the fraudulent conveyance litigation *and* the WARN litigation. *See id.* at 34, 1274. As a result, the final settlement agreement resolved all disputes among all stakeholders *except* petitioners, who insisted on pursuing the WARN litigation against both Jevic and SCPI. As a result, the Sun defendants refused to participate in any settlement that would fund petitioners' ongoing WARN claims. *See id.* at 1363.

In June 2012, respondents filed a joint motion asking the bankruptcy court to approve their settlement and dismiss the Chapter 11 cases upon implementation of the settlement. Under the settlement, in exchange for dismissal of the fraudulent conveyance action, CIT agreed to pay $2 million into an account earmarked for the estates' unpaid administrative expenses, and Sun Fund IV assigned its lien on Jevic's remaining $1.7 million to a trust, which would pay priority administrative creditors first and then general unsecured creditors on a *pro rata* basis. *See id.* at 390-96; *see also* Pet. App. 5a.

Petitioners objected to the proposed settlement. At an evidentiary hearing in November 2012, however, they presented no evidence of their own, and mounted no real challenge to any of the evidence presented by respondents. Instead, they relied on the legal argument that the settlement violated the Code. The bankruptcy court rejected that argument. The court acknowledged that "the proposed distributions are not in accordance with the absolute priority rule" because some settlement funds flowed to general unsecured creditors with a lower statutory priority than petitioners. Pet. App. 58a. That point, however, was not dispositive: "[B]ecause this is not a plan, and there is no prospect here of a confirmable plan being filed, the absolute priority rule is not a bar to approval of this settlement." *Id.*

The bankruptcy court therefore exercised its discretion under Federal Rule of Bankruptcy Procedure 9019 to approve the settlement. *See* Pet. App. 45-52a, 53-66a. As the court explained, "dire circumstances" justified distribution under the settlement and the subsequent dismissal of the debtors' Chapter 11 cases. *Id.* at 57a. In particular, the fraudulent conveyance claim was a long shot that the estates lacked funds to pursue and was an unattractive case for contingency counsel. *Id.* at 61a ("[O]n these facts I think any lawyer or firm that signed up for that role should have his head examined.").

In addition, the court held that dismissal of the Chapter 11 cases was appropriate because there was no feasible alternative. The Chapter 11 cases had "been pending for years ... with no reasonable prospect of a confirmable plan." *Id.* at 56a. There

were "no assets or funds that are not subject to the liens of CIT and Sun Capital," no "resources to creditably prosecute the Committee's lawsuit," no "resources to, otherwise, wrap up these bankruptcy proceedings," and no reasonable prospect of a meaningful "distribution to unsecured creditors" absent the settlement. *Id.* Aside from the pending fraudulent conveyance litigation, "[a]ll material tasks needed to administer the estates ha[d] already been completed." *Id.*

Nor was conversion to Chapter 7 a feasible alternative. A Chapter 7 trustee would have no "money to operate, investigate or litigate" the claims, and the "lenders have stated unequivocally and credibly that they would not do this deal in a Chapter 7." *Id.* at 58a. Thus, in the event of a Chapter 7 conversion, "the settlement proceeds would be taken by the secured creditors in relatively short order ... with nothing left over for stakeholders." *Id.* Faced "with two options, a meaningful return or zero," the court chose the former. *Id.* at 61a.

Subsequently, in May 2013, the bankruptcy court issued two important rulings in the ongoing WARN litigation. *First*, the court granted SCPI summary judgment on the ground that it was not a "single employer" with Jevic for purposes of WARN liability under either federal or state law. *See* CA3 JA1139-58.[2] *Second*, the bankruptcy court held that

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[2] Petitioners appealed that ruling, but the district court affirmed. *See In re Jevic Holding Corp.*, 526 B.R. 547 (D. Del. 2014). Petitioners again appealed that ruling, and that appeal remains pending before the Third Circuit. *See* CA3 No. 14-4331 (submitted without argument on October 27, 2015).

petitioners could not establish liability against Jevic under the federal WARN Act (which contains an "unforeseeable business circumstances" exception), but had established liability against Jevic under the New Jersey WARN Act (which contains no such exception). *See* CA3 JA1159-76.

2. District Court

Petitioners appealed the bankruptcy court's order approving the settlement to the district court, which affirmed in January 2014. *See* Pet. App. 35-43a. The district court concluded that the bankruptcy court had not abused its discretion by deciding on this record that the settlement "was in the best interest of the estate and of resolving the pending Chapter 11 cases." *Id.* at 40-41a (citing *In re Martin*, 91 F.3d 389, 393 (3d Cir. 1996)).

In particular, the district court agreed with the bankruptcy court that the absolute priority rule, codified in 11 U.S.C. § 1129(b), applies only to Chapter 11 *plans*, not *settlements*. Because a settlement "is not a reorganization plan," it is subject only to the "criteria for approval under Bankruptcy Rule 9019 and the standards set forth under *In re Martin*." Pet. App. 42a (internal quotation omitted). In addition, the court concluded that petitioners' appeal of the bankruptcy court's order was equitably moot, because "the settlement has been substantially consummated and all the funds have been distributed." *Id.* at 43a.

3. Third Circuit

Petitioners again appealed, and Third Circuit affirmed. Pet. App. 1-32a. The court adopted the legal standard set forth by the Second Circuit in

Iridium—"which, we note, [petitioners] ... cite throughout their briefs and never quarrel with." Pet. App. 19a. Under that standard, "bankruptcy courts may approve settlements that deviate from the priority scheme of § 507 of the Bankruptcy Code," but "*only* if they have 'specific and credible grounds to justify [the] deviation.'" Pet. App. 21a (emphasis added; quoting *Iridium*, 478 F.3d at 466).

Applying the *Iridium* standard, the panel majority held that this is the "rare" case in which a bankruptcy court had discretion to approve a settlement that deviated from the absolute priority rule. Pet. App. 2a, 12a, 23a. The majority based that conclusion on the bankruptcy court's factual finding that the settlement here was "the least bad alternative since there was 'no prospect' of a plan being confirmed and conversion to Chapter 7 would have resulted in the secured creditors taking all that remained of the estate in 'short order.'" *Id.* at 21a (quoting Pet. App. 58a); *see also id.* at 23a (highlighting the bankruptcy court's "sound findings of fact that the traditional routes out of Chapter 11 are unavailable and the settlement is the best feasible way of serving the interests of the estate and its creditors"). As the majority explained, "[t]he distribution of Jevic's remaining $1.7 million to all creditors but [petitioners] was permissible for essentially the same reasons that the initial distribution of estate assets to the litigation fund was allowed by the Second Circuit in *Iridium*." Pet. App. 22a. "As in that case, here the Bankruptcy Court had to choose between approving a settlement that deviated from the priority scheme of § 507 or rejecting it so a lawsuit could proceed to deplete the estate." *Id.*

Judge Scirica concurred in part and dissented in part. As relevant here, he agreed with the majority's decision to adopt the legal standard set forth by the Second Circuit in *Iridium*. *See* Pet. App. 24a ("I would also adopt the Second Circuit's standard from [*Iridium*]."). He differed with the panel majority only with respect to the application of that legal standard to the facts of this case. Pet. App. 24-31a. In particular, he proposed unilaterally rewriting the settlement to provide petitioners a recovery in accordance with their statutory priority. *Id.* at 32a.

Petitioners sought rehearing *en banc*. *See* Supp. App. 1-17a. In their petition, they never suggested that the panel had erred by adopting the legal standard set forth by the Second Circuit in *Iridium*. To the contrary, they again endorsed that legal standard, and simply argued that the panel majority misapplied it in this case. *See* Supp. App. 13-15a; *see also id.* at 2a (certifying a belief that the decision below "conflicts with or departs from" *Iridium*); 13a ("*Iridium* ... provides no support for the panel majority's conclusion; in fact, its reasoning precludes the panel's holding."). The Third Circuit denied the petition without recorded dissent. Pet. App. 67-68a.

REASONS FOR DENYING THE PETITION

I. The Circuit Split Alleged By Petitioners Is Illusory.

Petitioners contend that this Court's review is warranted, first and foremost, because "there is a square and acknowledged split among the circuits on the question presented." Pet. 15 (capitalization modified); *see also id.* 15-18. "In the Fifth Circuit," petitioners assert, "all distributions of settlement proceeds in a bankruptcy case (absent consent) must

comply with the Code's priority scheme." *Id.* (referring to *AWECO*, 725 F.2d 293). "In the Second Circuit," in contrast, "distributions of settlement proceeds made outside a plan need not adhere to the priority scheme." *Id.* (referring to *Iridium*, 478 F.3d 452). Petitioners complain that "[t]he decision below considered this existing circuit split, rejected the Fifth Circuit's rule, and chose to follow the Second Circuit's approach." *Id.*

That alleged conflict is illusory. There is not a single reported decision from *any* circuit holding that any provision of the Bankruptcy Code extends the absolute priority rule to settlements. *AWECO* involved the validity of a pre-plan settlement of litigation in a bankruptcy proceeding ultimately heading toward a reorganization plan. *See* 725 F.2d at 298 (noting that the case involved "approval of compromises that *form part of a plan* of reorganization") (emphasis added). Indeed, the Fifth Circuit framed the question presented as the standard for approving a settlement over a creditor's objection "*in the period prior to confirmation of a reorganization plan.*" *Id.* (emphasis added). The settlement there "disbursed a very significant portion of [the debtor's] estate to one of its unsecured, nonpriority creditors," *id.* at 295, and the bankruptcy court approved that settlement without making any factual findings about how much money the estate would retain to pay secured and priority creditors, including the Internal Revenue Service, in the eventual plan, *see id.* at 296-97.

The Fifth Circuit vacated the order approving the settlement. *See id.* at 300. As the court explained, the bankruptcy court had abused its discretion by

"bless[ing] the settlement without sufficient factual information to determine if the settlement was fair and equitable." *Id.* at 300; *see also id.* at 299 ("An approval of a compromise, absent a sufficient factual foundation, inherently constitutes an abuse of discretion."). Accordingly, the Fifth Circuit remanded the case for the bankruptcy court to re-evaluate the settlement based on a sufficient factual record. *See id.* at 300. The appellate court emphasized that its ruling "has no necessary implications beyond the present, limited context." *Id.* at 298.

In a single sentence of *dicta*, however, the Fifth Circuit—the first appellate court to address the issue—stated that "a bankruptcy court abuses its discretion in approving a settlement with a junior creditor unless the court concludes that priority of payment will be respected as to objecting senior creditors." *Id.* at 298. The court made no effort to anchor that blanket statement in *any* provision of the Bankruptcy Code. To the contrary, the court frankly based that assertion on "[o]ur understanding of bankruptcy law's *underlying policies*." *Id.* (emphasis added); *see also id.* ("[W]e find the *policy arguments* convincing ....") (emphasis added).

No appellate court returned to the issue for more than twenty years, until the Second Circuit in *Iridium*. *See* 478 F.3d 452. *Iridium*, like *AWECO*, involved the validity of a pre-plan settlement of litigation in a proceeding ultimately heading toward a reorganization plan. *See id.* at 455. Unlike *AWECO*, however, *Iridium* looked to statutory text, not policy arguments, as its starting point. As the Second Circuit recognized, nothing in the

Bankruptcy Code extends the absolute priority rule to settlements. *See id.* at 463 (citing *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968)).

Accordingly, the *Iridium* court qualified the sentence of *dicta* from *AWECO* described above. Because the Code does not extend the absolute priority rule to settlements, there is no warrant for courts to do so. In particular, "a rigid *per se* rule cannot accommodate the dynamic status of some pre-plan bankruptcy settlements." *Id.* at 464.

The *Iridium* court, however, commended *AWECO* for "accurately captur[ing] the potential problem a pre-plan settlement can present for the rule of priority." *Id.* In particular, a debtor cannot use a settlement "as a means to avoid the priority strictures of the Bankruptcy Code." *Id.* Thus, "whether a pre-plan settlement's distribution plan complies with the Bankruptcy Code's priority system will be the *most important factor* for a bankruptcy court to consider in approving a settlement under Bankruptcy Rule 9019," and "[i]n most cases, it will be dispositive." *Id.* at 455 (emphasis added); *see also id.* at 464.

Applying that standard, the Second Circuit upheld the disputed settlement in part, and vacated and remanded it in part for clarification of one provision. *See id.* at 465-66. The court acknowledged that deviation from the absolute priority rule is permissible where the alternative "present[s] too much risk for the Estate," and indeed risks "devastat[ing]" the estate and leaving all creditors worse off without any corresponding benefit. *Id.* at 465-66.

As an initial matter, this case presents a different issue than either *AWECO* or *Iridium*, because the settlement here is not a prelude to the eventual confirmation of a reorganization plan. To the contrary, the bankruptcy court approved the settlement in this case precisely because "there is *no* prospect here of a confirmable plan being filed." Pet. App. 58a (emphasis added). By definition, there can be no evasion of the requirements for plan confirmation where, as here, there is no prospect of plan confirmation in the first place.

In any event, the sentence in *AWECO* declaring that the absolute priority rule applies to approval of settlements is *dicta*, because the Fifth Circuit in that case vacated the order approving the settlement for lack of a proper factual foundation. *See* 725 F.2d at 298. *Iridium* affirmatively endorsed the concerns expressed by the Fifth Circuit in *AWECO*, but simply recognized that the blanket sentence of *dicta* was "too rigid." 478 F.3d at 464. While *Iridium* thus qualified *AWECO*'s *dicta*, it did so in the context of reaffirming *AWECO*'s central message that pre-plan settlements may not be used to evade plan confirmation requirements. *See id.*

Even if *Iridium*'s rejection of the *AWECO dicta* were deemed to create a "circuit split," Pet. 15, it would be one of the shallowest sort. Only three appellate decisions have addressed this issue: *AWECO*, *Iridium*, and the decision below. The Fifth Circuit in *AWECO* was the first appellate court to address the issue, more than thirty years ago, and thus had no basis to understand the myriad factual scenarios in which it could arise. The Second Circuit, and the Third Circuit below, simply

recognized that the Fifth Circuit wrote a single sentence of *dicta* that sweeps too broadly. The Fifth Circuit has not revisited the issue subsequent to either the Second or Third Circuit decisions—indeed, the Fifth Circuit has not revisited the issue since *AWECO* itself, and thus has never had a chance to reconsider the disputed *dicta* in light of the critique thereof by the Second and Third Circuits. And petitioners fail to identify a single case in the decades since *AWECO* that relied on that *dicta* to reject a bankruptcy settlement, thus belying any suggestion that this Court's immediate intervention is necessary to provide clarity to the lower courts or that this "is not an appropriate case to leave the issue to percolate in the other courts of appeals." NELP Br. 5.

II. The Decision Below Is Correct.

Petitioners next contend that this Court's review is warranted because "[t]he Third Circuit's decision is incorrect." Pet. 19 (capitalization modified); *see also id.* at 19-26. According to petitioners, the decision "cannot be squared with the text, structure, or purpose of the Code." *Id.* at 19. They are wrong on all counts.

As a threshold matter, nothing in the Code's text extends the absolute priority rule to *settlements*, as opposed to *plans*. As this Court has explained, the rule is "now on the books as subsection (b)(2)(B)(ii)," *i.e.*, 11 U.S.C. § 1129(b)(2)(B)(ii). *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 449 (1999). By its plain terms, the rule applies only to a "plan." *See* 11 U.S.C. § 1129(b)(2)(B)(ii) ("[T]he condition that a *plan* be fair and equitable with respect to a class includes the

following requirements ... With respect to a class of unsecured claims ... the holder of any claim or interest that is junior to the claims of such class will not receive or retain *under the plan* on account of such junior claim or interest any property.") (emphasis added). Indeed, Section 1129, in which the rule is codified, is entitled "Confirmation of *plan*" and describes the "requirements" for a court to "confirm a *plan*." *Id.* § 1129(a) (emphasis added); *see also* Pet. App. 17a ("When Congress codified the absolute priority rule ..., it did so in the specific context of plan confirmation, *see* § 1129(b)(2)(B)(ii), and neither Congress nor the Supreme Court has ever said that the rule applies to settlements in bankruptcy.").

Petitioners insist, however, that "[a]s a textual matter, the priority scheme in § 507 applies in all chapter 11 cases *at all times*, even prior to the approval of a plan." Pet. 20 (emphasis added; citing 11 U.S.C. § 103(a)). As the Third Circuit explained, that is simply not true. *See* Pet. App. 15-17a & n.7. Section 507 describes the priority of particular "expenses and claims," 11 U.S.C. § 507, but does not specify the circumstances under which bankruptcy courts are required to apply those priorities. That is why Congress enacted Section 1129 to specify that the priorities set forth in Section 507 apply to plans. *See* 11 U.S.C. § 1129; *see also* Pet. App. 16a n.7 ("If § 103(a) meant that all distributions in Chapter 11 cases must comply with the priorities of § 507, there would have been no need for Congress to codify the absolute priority rule specifically in the *plan* confirmation context.") (emphasis added). Petitioners tellingly cite *no* case holding that Section 507 applies to settlements. Indeed, as the Third

Circuit noted, "[petitioners] themselves *admit* that the absolute priority rule 'plainly does not apply here,' even as they insist that the legal principle embodied by the rule dictates a result in their favor." Pet. App. 17a (emphasis added; quoting Petrs.' CA3 Br. 37).

Petitioners thus frame the issue precisely backwards by complaining that the Third Circuit failed to "point[] to any provision of the Code permitting ... a departure" from the absolute priority rule. Pet. 20. As the Third Circuit recognized, and petitioners conceded below, the Code by its plain terms does not extend the rule to settlements in the first place. If Congress does not like that result, Congress is of course free to amend the Code at any time to extend the priority rule to bankruptcy settlements.[3]

Nor is it true, as petitioners assert, that "the Second and Third Circuit's rule is ... discordant with this Court's case law addressing absolute priority." Pet. 23-26. None of the cases cited by petitioners remotely suggests that the absolute priority rule applies to settlements (at least insofar as they are not part and parcel of a reorganization plan, *see TMT Trailer Ferry*, 390 U.S. at 424). And both the Second

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[3] Petitioners' extended argument that Section 105(a) of the Code, 11 U.S.C. § 105(a), did not authorize the bankruptcy court to approve the settlement, *see* Pet. 7, 12-13, 21-23, misses the mark: the Third Circuit never invoked that provision to justify its decision. To the contrary, the authority for a bankruptcy court to approve a settlement comes from Bankruptcy Rule 9019, and the whole question here is whether the Code absolutely limits that authority to settlements that comply with the absolute priority rule. Petitioners' discussion of Section 105(a) is thus a red herring.

and Third Circuits went out of their way not only to acknowledge but to emphasize the importance of the priority system in bankruptcy. *See Iridium*, 478 F.3d at 463-64; Pet. App. 20-21a. Those courts simply recognized, as petitioners do not, that priority is not the *only* policy protected by the Bankruptcy Code. Among other things, the Code also encourages maximizing value to the estate, which is precisely what the court did here by approving the settlement.

There is thus nothing about the decision below inconsistent with either the "structure" or the "purpose" of the Code. "As in other areas of the law," the Third Circuit explained, "settlements are favored in bankruptcy," and "it is an unusual case in which there is not some litigation that is settled between the representative of the estate and an adverse party." Pet. App. 19-20a (internal quotation omitted). "Given the 'dynamic status of some pre-plan bankruptcy settlements,' it would make sense for the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure to leave bankruptcy courts more flexibility in approving settlements than in confirming plans of reorganization." *Id.* at 20a (quoting *Iridium*, 478 F.3d at 464).

To say that the Code's priority system does not apply of its own force to settlements, however, is not to say that the Code's priority system is irrelevant to settlements. To the contrary, the Third Circuit "agree[d] with the Second Circuit's statement that compliance with the Code priorities *will usually be dispositive* of whether a proposed settlement is fair and equitable." Pet. App. 20a (emphasis added; citing *Iridium*, 478 F.3d at 455); *id.* at 21a ("We ... hold that bankruptcy courts may approve

settlements that deviate from the priority scheme of § 507 of the Bankruptcy Code *only* if they have 'specific and credible grounds to justify [the] deviation.'") (emphasis added; quoting *Iridium*, 478 F.3d at 466); *id.* at 23a (deviations from Code's priority system are "likely to be justified only rarely"). "Although [respondents] have persuaded us to hold that the Code and the Rules do not extend the absolute priority rule to settlements in bankruptcy, we think that the policy underlying that rule—ensuring the evenhanded and predictable treatment of creditors—applies in the settlement context." *Id.* at 20a.

In particular, the Third Circuit held that the bankruptcy court below had acted within its discretion in approving the settlement at issue here *only* because that court had made detailed factual findings that "there was 'no realistic prospect' of a meaningful distribution to anyone but the secured creditors unless the settlement were approved because the traditional routes out of Chapter 11 bankruptcy were impracticable." Pet. App. 8a (quoting CA3 JA32); *see also id.* at 4-9a, 21-23a. Indeed, as the Third Circuit noted, petitioners "mount no real challenge to the Bankruptcy Court's findings that there was no prospect of a confirmable plan in this case and that conversion to Chapter 7 was a bridge to nowhere." *Id.* at 14-15a; *see also id.* at 40a (district court's observation that petitioners "largely do not contest the bankruptcy court's factual findings"). Petitioners' current suggestion that "[h]ere, ... it may well have been possible to negotiate a settlement on terms to which all creditors would consent," Pet. 30, thus "rests on [a] counterfactual premise," Pet. App. 21a.

That is the basic problem for petitioners: they do not like the settlement, but they cannot (and have not tried to) overcome the bankruptcy court's factual finding that there was no feasible alternative that would leave anyone—*including petitioners themselves*—better off. As counsel for the U.S. Trustee, supporting petitioners below, put it: "'[W]e have to accept the fact that we are sometimes going to get a really ugly result, an economically ugly result, but it's an economically ugly result that is dictated by the provisions of the code.'" Pet. App. 23a (quoting CA3 JA1327). The Third Circuit, with considerable understatement, responded that "[w]e doubt that our national bankruptcy policy is quite so nihilistic and distrustful of bankruptcy judges." *Id.* The bankruptcy court was even more blunt: the Bankruptcy Code "is not a suicide pact." CA3 JA1318.

Indeed, petitioners' insistence on the absolute priority rule here is ironic. It is undisputed, after all, that respondents CIT and Sun Fund IV had a higher statutory priority than petitioners. Thus, if the case had been converted to a Chapter 7 liquidation—as petitioners concede would be perfectly fine—CIT and Sun Fund IV would have been entitled to receive *all* of the estates' assets in short order, in light of the bankruptcy court's undisputed factual findings that the estates had no more funds to pursue the fraudulent-conveyance litigation and could not obtain contingency counsel. *See* Pet. App. 58a, 61a. Petitioners can hardly complain that other creditors received something instead of nothing where, as here, petitioners themselves would have received nothing under either scenario.

If anything, this case is the exception that proves the rule. Petitioners' parade of horribles, *see* Pet. 26-31, presumes the decision below does not mean what it says. The Third Circuit emphasized that, in light of the bankruptcy court's careful factual findings, this is the "rare" case in which a settlement deviating from the Code's priority system is valid. Pet. App. 2a, 12a, 23a. In particular, the court took pains to note that "bankruptcy courts cannot approve settlements and structured dismissals devised by certain creditors in order to increase their shares of the estate at the expense of other creditors." *Id.* at 20-21a; *see also Iridium*, 478 F.3d at 464 ("The [bankruptcy] court must be certain that parties to a settlement have not employed a settlement as a means to avoid the priority strictures of the Bankruptcy Code.").

Petitioners and their *amici* predict that the decision will be invoked to bless collusive settlements that circumvent the priority rule. *See* Pet. 27; *see also* Ill. Br. 15; NELP Br. 17; Profs. Br. 18-21. They warn that "bankruptcy law is replete with examples of remedies initially approved only as 'exceptional,' but that ultimately become commonplace." Pet. 28. And petitioners' *amici* States warn that the decision below opens the door to tax-related priorities being skipped, *see* Ill. Br. 12, even though the settlement here resulted in full payment to unsecured priority tax claimants who otherwise would have recovered nothing, *see* CA3 JA16.

Similarly unavailing is petitioners' complaint that the decision below is likely to reduce creditors' "leverage" in future negotiations "because of the risk that future '*Jevic*' settlements will be approved."

Pet. 31. Siding with petitioners, however, would grant recalcitrant priority creditors, in cases involving limited assets, *all* of the "leverage"—the ability to demand payment in full even when doing so destroys any hope of maximizing value through settlement, to the detriment of more senior and more junior creditors alike. The Bankruptcy Code gives administrative and priority creditors such "leverage" in the *plan* context, but not in the *settlement* context.

In any event, petitioners' dire predictions do not warrant this Court's review in this case. If and when these predictions ever come to pass, aggrieved parties are always free to seek review. Indeed, if petitioners are correct that the issue is a "recurring" one, Pet. 18—although so far it has reached the appellate level only three times in more than thirty years—there will be ample opportunity for this Court to address the issue.[4]

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[4] In passing, petitioners cast doubt on the validity of "structured dismissals" of Chapter 11 cases, which do not culminate in either a confirmed reorganization plan or a conversion to Chapter 7 liquidation. *See* Pet. 3. The petition, however, does not present the question whether the Bankruptcy Code permits structured dismissals under Chapter 11. *See id.* at i (presenting only the question "[w]hether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme"). Petitioners' decision not to raise the question whether the Code permits structured dismissals under Chapter 11 is hardly surprising, given that there is not even arguably a circuit conflict on that question. Indeed, *amici* NELP *et al.* declare that the "issue of ... structured settlements was percolating for some time in the lower courts within the Third Circuit before the decision below," but cite only decisions *approving* the practice. NELP Br. 6 n.3; *cf.* Profs. Br. 1, 11 (alleging an "implicit" split between the decision below and *In re Sadler*, 935

III. This Case Is Not An Appropriate Vehicle For Addressing The Question Presented.

Above and beyond all the foregoing, this case is not an appropriate vehicle for this Court to resolve the alleged conflict between the Second and Third Circuit, on the one hand, and the Fifth Circuit, on the other. In the Third Circuit, everyone—the panel majority, the partial dissent, petitioners, and respondents—accepted the legal standard set forth in *Iridium*. As the Third Circuit noted, petitioners cited *Iridium* "throughout their briefs and never quarrel[led] with" it. Pet. App. 19a. The Third Circuit panel majority accepted petitioners' invitation to follow the *Iridium* approach, as did Judge Scirica in partial dissent. *See id.* ("We agree with the Second Circuit's approach in *Iridium*."); *see also id.* at 24a (Scirica, J., concurring in part and dissenting in part) ("I would also adopt the Second Circuit's standard from [*Iridium*].").

Thus, in the Third Circuit, petitioners challenged nothing more than the *application* of the *Iridium* legal standard to the facts of this case. And even after the Third Circuit decision, in their petition for rehearing *en banc*, petitioners never argued that the panel majority erred by applying the legal standard set forth in *Iridium*; to the contrary, petitioners again argued only that the majority had *misapplied* that legal standard. *See* Supp. App. 13-15a. Indeed, petitioners' current argument that the Third Circuit erred by "opting to *follow* the Second Circuit's decision in *Iridium*," Pet. 14 (emphasis added),

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F.2d 918 (7th Cir. 1991), which does not address—or even mention—structured dismissals under Chapter 11).

cannot be squared with their insistence below that the panel majority erred by *failing* to follow *Iridium*. *See* Supp. App. 2a, 8a, 12a, 13a, 15a.[5]

In particular, petitioners never suggested below that the Third Circuit needed to choose between *AWECO* and *Iridium*. To the contrary, they cited both cases with approval, and argued that they should prevail under either approach. By arguing now that the Third Circuit erred as a matter of law by adopting the *Iridium* approach, they are trying to sandbag the Third Circuit. This Court should neither tolerate nor reward such gamesmanship.

CONCLUSION

For the foregoing reasons, this Court should deny the petition for writ of certiorari.

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[5] That argument is still advanced by petitioners' off-message *amici* Illinois *et al.* Rather than agreeing with petitioners' current position that the Third Circuit erred by "follow[ing] the Second Circuit's approach," Pet. 15, these *amici* assert that "[i]t is not possible to reconcile" the Third Circuit's legal standard with the Second Circuit's "intermediate position." Ill. Br. 10, 11.

January 19, 2016

Respectfully submitted,

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SUPPLEMENTAL APPENDIX

No. 14-1465

United States Court of Appeals for the Third Circuit

In re: Jevic Holding Corp., *et al.*,
Debtors

OFFICIAL COMMITTEE OF UNSECURED CREDITORS
on behalf of the bankruptcy estates of
Jevic Holding Corp., *et al.*

v.

CIT GROUP/BUSINESS CREDIT, INC., in its capacity as Agent; SUN CAPITAL PARTNERS, INC.; SUN CAPITAL PARTNERS IV, LP; SUN CAPITAL PARTNERS MANAGEMENT IV, LLC

CASIMIR CZYZEWSKI; MELVIN L. MYERS; JEFFREY OEHLERS; ARTHUR E. PERIGARD; AND DANIEL C. RICHARDS, on behalf of themselves and all others similarly situated,
Appellants.

On Appeal from the United States District Court for the District of Delaware,
Nos. 13-cv-104, 13-cv-105, Before the Honorable Sue L. Robinson

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STATEMENT OF COUNSEL

I express a belief, based on a reasoned and studied professional judgment, that the panel decision permitting a settlement agreement "that deviates from the Bankruptcy Code's priority system" (Op. 5) conflicts with or departs from the following decisions of other United States Courts of Appeals: *In re AWECO, Inc.*, 725 F.2d 293 (5th Cir. 1984); *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007). Consideration by the full Court is therefore necessary to secure and maintain uniformity of federal law on this question of exceptional importance.

BACKGROUND

A. The Bankruptcy Code's Priority Scheme

Section 507 of the Bankruptcy Code sets forth the priority scheme for the payment of creditors in bankruptcy. It applies to cases under all chapters of the Bankruptcy Code—chapters 7, 12, and 13, as well as chapter 11, the chapter under which this case was filed. 11 U.S.C. § 103(a).

After secured creditors are paid in full, the assets of the estate flow like a waterfall through the ten classes of priority claims specified in § 507. Priority claims include, for example, administrative expenses, 11 U.S.C. § 507(a)(2); alimony and child support, *id.* § 507(a)(1); taxes, *id.* § 507(a)(8); and, pertinently, unpaid wages and employee benefits accrued within the 180 days prior to the commencement of the bankruptcy case or cessation of the debtor's business, *id.* § 507(a)(4)-(5). *See* 4 *Collier on Bankruptcy* ¶ 507.01 (16th ed. 2015). Each priority claimant is entitled to payment of its

priority claim in full before any junior class of creditors or interest-holders is paid anything at all.

On occasion, Congress alters the § 507 scheme of priorities. *E.g.*, 11 U.S.C. § 364(c) (granting a superpriority right to lenders who extend credit to a debtor after the petition date); U.S. Amicus Br. 15-16 (collecting examples). But absent some specific Code provision prescribing alternative treatment, the rule is clear: Unless priority creditors are paid first, no estate property is distributed to junior creditors. 4 *Collier on Bankruptcy* ¶ 507.02[1]. And in chapter 11, no plan of reorganization may be confirmed without paying allowed priority claims in full, unless "the holder of a particular [priority] claim has agreed to a different treatment of such claim." 11 U.S.C. § 1129(a)(9).

The Code provides two options for a chapter 11 debtor that is unable to confirm a plan of reorganization. *First*, the debtor may convert to chapter 7, leading to liquidation rather than reorganization. 11 U.S.C. § 1112(a). The rules for distribution of assets in chapter 7 incorporate the priority scheme of § 507. *Id.* § 726(a)(1). *Second*, a chapter 11 debtor that cannot confirm a reorganization plan may instead dismiss its bankruptcy case. *Id.* § 1112(b). The Code provides that after voluntary dismissal of a chapter 11 case, creditors retain the same state-law rights they had prior to the bankruptcy. *Id.* § 349.

B. Jevic Bankruptcy, Priority-Skipping Settlement, And Dismissal

The debtor, Jevic Transportation, Inc., was a New Jersey-based trucking company. In 2006, in a period of financial distress, Jevic was acquired in a

leveraged buyout by Sun Transportation, LLC, a portfolio company of the private equity group Sun Capital Partners. A group of lenders led by CIT Group financed the buyout. CIT also extended a line of credit to Jevic after the buyout. Op. 5.

Jevic's fortunes continued to decline; as of December 2007, it owed CIT $53.2 million under the credit facility. To prevent CIT from foreclosing on assets securing the loans, Jevic and CIT entered into a forbearance agreement, which included a guaranty by Sun. In May 2008, with expiration of the forbearance agreement looming, Jevic began to wind down operations. On May 19, 2008, it notified its employees that they would be terminated. It filed a voluntary chapter 11 petition the next day. "At that point, Jevic owed about $53 million to its first-priority senior secured creditors (CIT and Sun) and over $20 million to its tax and general unsecured creditors." Op. 5.

Appellants represent a certified class of approximately 1,800 truck drivers who sued Jevic and Sun in the bankruptcy case in May 2008. The drivers alleged that Jevic, at Sun's direction, had fired them without complying with state and federal laws requiring 60 days' written notice of termination. The state-law claims against Jevic were ultimately undisputed, and the drivers estimate their damages to be $12.4 million. Op. 8 & n.2. A substantial portion of the drivers' undisputed claims—approximately $8.3 million—qualify as wage and benefit claims incurred within 180 days of the commencement of the bankruptcy case, and thus are entitled to priority under § 507(a)(4) and (5). Op. 9; Appellants' Br. 6-7.

The committee of Jevic's general unsecured creditors also brought a second suit in the bankruptcy case on behalf of the estate itself: a fraudulent conveyance action against Sun and CIT, alleging in substance that the leveraged buyout the two companies had orchestrated had caused Jevic to fail. Op. 6. The committee sought to recover $100 million. Appellants' Br. 7. Had the committee prevailed, the proceeds from the suit would have belonged to the bankruptcy estate and would have been distributed to Jevic's creditors like other estate assets.

In June 2012, the committee, Sun, and CIT sought the bankruptcy court's approval of a settlement to resolve the fraudulent conveyance action and to dismiss the bankruptcy case. Under the final terms of the settlement, CIT agreed to pay $2 million towards the claims of various priority administrative creditors, including the committee's counsel. Sun agreed to assign a lien it held on Jevic's remaining $1.7 million in cash into a trust to pay certain other administrative and tax creditors and then general unsecured creditors on a pro rata basis. The fraudulent conveyance action and the bankruptcy case would both be dismissed, and the settling parties would release all claims against each other. Op. 7-8.[1]

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[1] The only form of dismissal expressly contemplated by the Code is one that returns the parties-in-interest to their pre-petition status. 11 U.S.C. § 349(b)(3). Here, by contrast, the settling parties sought a so-called "structured dismissal," in which the dismissal is accompanied by orders that modify the rights of the parties- in-interest going forward. *See* Pernick & Dean, *Structured Chapter 11 Dismissals*, Am. Bankr. Inst. J., June 2010, at 1, 57-58. Over the drivers' objection, the panel

The drivers—the holders of undisputed priority claims superior in priority to the claims of general unsecured creditors—received nothing. The carve-out for the drivers was no accident: Sun's counsel acknowledged that Sun, a named defendant in the drivers' suit, had no interest in "'funding somebody who is suing'" it. Op. 9 n.4. Both the drivers and the U.S. Trustee objected to approval of the settlement on the ground that it would violate the Code's strict priority scheme because it would result in the distribution of estate assets to general unsecured creditors even though the drivers, with their priority wage claims, would get nothing. Op. 10.

The bankruptcy court nevertheless approved the settlement and entered the structured dismissal. JA30-36; Op. 10-12. It accepted the settling parties' view that there was "'no realistic prospect'" of confirming a chapter 11 plan, nor sufficient remaining unencumbered estate assets to fund an orderly liquidation under chapter 7 if the case were converted. Op. 11. It also discounted the possibility that the drivers might obtain payment of their priority claims if the settlement were rejected, given Jevic's lack of unencumbered assets and what the court perceived as the "'uncertain at best'" prospects of any recovery for the estate in the fraudulent conveyance action. Op. 12. The district court affirmed for substantially the same reasons. JA 13-21; Op. 12-13.

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held that structured dismissals are permissible in some circumstances. Op. 17-18.

C. The Panel Decision

A divided panel of this Court also affirmed. The majority was troubled by the settlement's deviation from the Code's priority scheme, calling the case a "close call." Op. 24. The majority also acknowledged that settlement agreements entered into as part of a chapter 11 reorganization plan must comply with the Code's priority rules if they result in the distribution of estate assets (Op. 19), and that the Fifth Circuit had held in *In re AWECO, Inc.*, 725 F.2d 293 (5th Cir. 1984), that the same principles apply to any other pre-plan settlements in a bankruptcy case (Op. 20-21). But the majority rejected that guidance and instead purported to follow *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007), which it read as permitting settlements that deviate from the Code's priority scheme. Op. 21-24.

The majority thus held that "the Code permits a structured dismissal ... that deviates from the § 507 priorities" in the putatively "rare[]" circumstance when "the traditional routes out of Chapter 11 are unavailable and the settlement is the best feasible way of serving the interests of the estates and its creditors." Op. 26.

Judge Scirica dissented. In his view, "by approving the settlement, the bankruptcy court's order undermined the Code's essential priority scheme" by skipping over the drivers' priority claims in favor of payments of estate assets to general unsecured creditors. Dissenting Op. 1. Although he too suggested that in "extraordinary circumstances" *(id.)* the Code might permit a settlement that deviates from the Code's priority scheme, he did not find this to be such a case. In his view, the

settlement was not necessarily the option of last resort *(id.* at 2) and instead appeared to be "an end-run around the carefully designed routes by which a debtor may emerge from Chapter 11 proceedings" *(id.* at 5). In any event, the "determinative" factor against approval of the settlement here was that it "skips over an entire class of creditors" in distributing estate property *(id.* at 7)—a stark departure from § 507, which no other circuit has ever approved.

ARGUMENT

Under the panel majority's decision, a bankruptcy court may approve a settlement and structured dismissal that distributes estate assets contrary to the strict priority scheme set out in § 507 of the Code. The decision is contrary to the bedrock rules of priority for distribution of estate assets in bankruptcy. The decision is also contrary to the only two prior court of appeals decisions addressing priority-skipping settlements: *In re AWECO, Inc.*, 725 F.2d 293 (5th Cir. 1984), and *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007). *AWECO* flatly prohibits any such settlement, and *Iridium* prohibits the sort of bankruptcy-exiting, class-skipping settlement authorized in this case. Review by the full Court is warranted to ensure the uniformity of federal law on a question of considerable and increasing importance to bankruptcy law.

I. The Panel Decision Wrongly Permits A Deviation From The Code's Priority Scheme

A settlement of the type the panel approved here, which entirely skipped over the drivers in favor of unsecured general creditors, is an impermissible end

run around the priority scheme mandated by Congress in § 507. The basic rule of distribution of estate assets in bankruptcy is strict priority: Claims of higher priority must be paid in full before claims of lower priority. *See supra* pp. 1-2.[2] This has traditionally been described as the rule of "fair and equitable" distribution. *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 115-116 (1939). The tiers of priority typically reflect a creditor's non-bankruptcy state law rights, but Congress has also specified in § 507 that certain types of claims are categorically entitled to priority. *See* H.R. Rep. No. 95-595, at 357-358 (1977).

Here, the drivers possessed undisputed priority claims for unpaid wage and employee benefits under § 507(a)(4) and (5). Op. 9. The drivers were therefore entitled to payment of their priority claims in full before any estate assets could be distributed to lower priority claimants—including general unsecured creditors.

No provision of the Code authorizes a bankruptcy court to depart from the § 507 priority scheme when approving a settlement. To the contrary, when a bankruptcy court approves a settlement, it does so in the exercise of its general equitable powers. *See* 11 U.S.C. § 105(a) (permitting the court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title"); Fed. R. Bankr. P. 9019(a) (requiring court approval of settlements). "It is hornbook law that § 105(a)

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[2] Indeed, this rule predates the modern Code itself. *See, e.g., Louisville Trust Co. v. Louisville New Albany & Chi. Ry. Co.*, 174 U.S. 674, 684 (1899).

'does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code.'" *Law v. Siegel*, 134 S. Ct. 1188, 1194 (2014); *see* U.S. Amicus Br. 17 (explaining that the Supreme Court has repeatedly rejected "attempts to alter the statutory priorities set forth in the Code based on equitable considerations," and that "[i]t is Congress's prerogative to decide what types of claims will have priority").

The panel acknowledged that there was no statutory authority for the settlement approved in this case (Op. 19 n.7), but it drew exactly the wrong conclusion from that fact. In the panel's view, absent some affirmative indication that "Congress legislated with settlements in mind" when enacting the priorities scheme, there was no reason to suppose that settlements must comply with the scheme. *Id.*; *see* Op. 20 ("[N]either Congress nor the Supreme Court has ever said that the [absolute priority] rule applies to settlements in bankruptcy."). But the opposite inference from the statutory scheme is far more compelling. The priority scheme is one of the foundational principles of bankruptcy law. Had Congress intended to permit bankruptcy courts to circumvent this careful order of priorities by distributing estate assets pursuant to a settlement, rather than a confirmed plan of reorganization, surely it would have said so.

The panel reasoned that precedents requiring settlements to conform to the priority scheme when approved as part of a reorganization plan are distinguishable because the bankruptcy court here

was not confirming a plan. Op. 19-20.[3] Reorganization plans are governed by a specific form of the absolute priority rule, codified at § 1129(b)(2)(B)(ii). That section, as the panel noted, "'does not apply'" to approval of a pre-plan settlement. Op. 20. However, given the careful limits Congress placed on plan confirmation to ensure compliance with the absolute priority rule, the Code should not be read to permit settlements that evade those limits—particularly as a precursor to dismissal. *See* Appellants' Br. 20-21, 26-28.

The panel further reasoned that, had the priority scheme set out in § 507 been intended to apply generally throughout the Code, "there would have been no need for Congress to codify the absolute priority rule specifically in the plan confirmation context." Op. 19 n.l. But that argument is also misplaced. Each chapter of the Code has its own provision providing for distribution in accordance with the statutory priority scheme. 11 U.S.C. §§ 726, 1225, 1325. The inclusion of § 1129 thus does not imply the exclusion of strict priority elsewhere.

Congress's decision to prioritize certain claims categorically is given effect throughout the Code by § 507—itself made applicable to chapters 7, 11, 12, and 13 by § 103(a). Unless the Code expressly says otherwise, bankruptcy courts are bound to follow it, even when approving settlements.[4]

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[3] *See, e.g., Protective Comm. for Indep. Stockholders of TMT Trailer Ferry Inc. v. Anderson*, 390 U.S. 414, 424 (1968); *In re Armstrong World Indus., Inc.*, 432 F.3d 507, 513, 515 (3d Cir. 2005).

[4] On occasion, the Code *does* say otherwise, expressly authorizing departures from § 507. *See supra* p. 2. Congress is

II The Panel Decision Conflicts With Decisions Of The Second And Fifth Circuits

En banc review is also warranted because the panel decision conflicts with the only two prior decisions of other circuits addressing whether settlements may deviate from the Code's priority scheme.

In *AWECO,* the Fifth Circuit rejected a class-skipping settlement of the type at issue here. In that chapter 11 case, the bankruptcy court had approved a settlement, prior to plan confirmation, which distributed assets of the estate to non- priority creditors over the objection of priority claimants. 725 F.2d at 295-296. The court of appeals reversed. It noted that a bankruptcy judge has considerable discretion under Rule 9019 (then Rule 919) "whether to approve a particular compromise," but that the judge's discretion is cabined by the requirement that settlements be "fair and equitable." *Id.* at 297, 298. "The words 'fair and equitable' are terms of art" in bankruptcy, reflecting the fundamental requirement that "'senior interests are entitled to full priority over junior ones.'" *Id.* at 298. As such, "a bankruptcy court abuses its discretion in approving a settlement with a junior creditor unless the court concludes that priority of payment will be respected as to objecting senior creditors." *Id.* Any contrary rule, the court warned, would give "bankruptcy courts ... the discretion to favor junior classes of

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thus more than capable of identifying the situations where it does not wish its priority scheme to apply. The panel erred in effectively blessing an additional exception under the guise of equitable authority to approve settlements.

creditors so long as the approval of the settlement came before the plan." *Id.*

The panel majority acknowledged that its holding departs from "the per se rule of *AWECO*" (Op. 23), but it claimed to draw support instead from the Second Circuit's *Iridium* decision. *Iridium*, however, provides no support for the panel majority's conclusion; in fact, its reasoning precludes the panel's holding.

In *Iridium*, also a chapter 11 case, a committee of unsecured creditors brought an action on behalf of the estate against various secured creditors, as well as a separate action against Motorola, a putative administrative creditor. 478 F.3d at 458. The committee sought approval of a settlement of the first action, which provided funds to pursue the estate's "most significant asset," the multi-billion dollar suit against Motorola. *Id.* at 464. Under the settlement, the estate's remaining cash assets were largely split between the secured creditors and a litigation trust established to fund the suit against Motorola. *Id.* at 459. If the committee prevailed in the Motorola suit, the proceeds would be split between the lenders, administrative creditors, and the estate, "to be distributed according to a future, as-yet-unconfirmed reorganization plan." *Id.* Any funds remaining in the trust after the litigation would be distributed to unsecured general creditors. *Id.* Motorola objected primarily on the ground that the settlement called for residual money in the litigation trust to be distributed to unsecured creditors, skipping over Motorola's priority administrative claim. *Id.* at 465. The Court also

considered the propriety of the initial transfer of monies to the trust. *Id.* at 465-467.

Although the Second Circuit described *AWECO* as "too rigid," 478 F.3d at 464, it also held that "whether a particular settlement's distribution scheme complies with the Code's priority scheme must be *the most important factor* for the bankruptcy court to consider," *id.* (emphasis added), and indicated that a bankruptcy court may "endorse a settlement that does not comply in some minor respects with the priority rule" only upon a heavy justification for the deviation, *id.* at 464-465. The court also stressed that the settlement was not "an impermissible *sub rosa* plan of reorganization," and that the proposed settlement in the case was made to "clear[] the way for implementation of a reorganization plan." *Id.* at 466, 467. Still, it remanded for a determination of whether some "specific and credible grounds" justified the "possible" minor deviation in priority in distribution of excess funds from the litigation trust. *Id.* at 466.

The panel majority noted that *Iridium* also approved the initial transfer of monies to the litigation trust. Op. 21-22, 25 n.8. But the transfer was done at an early stage of the case to unlock pursuit of the estate's largest asset (the suit against Motorola), and the proceeds from the litigation would have flowed through the estate as part of a confirmed plan. *Iridium*, 478 F.3d at 467. The Second Circuit did not apparently view the transfer as a violation of the priority scheme. *See id.* at 466 (remanding based on "possible deviation from the [priority] rule in *one* regard" (emphasis added)); *see also* Dissenting Op. 7. In contrast, the settlement here evaded priority by

an "end-run around" around a chapter 11 plan or a chapter 11 exit through the express routes created by the Code. Dissenting Op. 5, 8.

Thus, as Judge Scirica explained, *Iridium* does not support the result reached by the panel majority. Dissenting Op. 7-8. Motorola might have been skipped over in favor of unsecured creditors *only* with respect to any small portion of funds remaining in the litigation trust. 478 F.3d at 465-466. The Second Circuit refused to allow that deviation from the Code's priority scheme absent further explanation, even though it was far less egregious than the deviation permitted here.

The certain outcome of the settlement and dismissal here was dismissal in lieu of a confirmed plan, with the drivers receiving nothing for their priority claims while payments of estate assets were made to unsecured creditors. Neither *Iridium* nor *AWECO* would permit that result. The panel's decision thus leaves the Court out of step with its sister circuits and should be reconsidered en banc.

III. If Allowed To Stand, The Panel Decision Will Invite Future Structured Dismissals That Carve Out Disfavored Creditors

The priority rule is an important safeguard for parties with claims that Congress has categorically afforded priority status in § 507. In negotiations over settlements and, ultimately, over reorganization plans, priority creditors were formerly safe in the knowledge that Congress had given them the right to be paid first, in full, before any lower priority claims are paid.

The panel decision seriously erodes that safeguard. The majority described the circumstances of this case as "rare." Op. 5. But the underlying circumstances are hardly "unusual" or *"sui generis"* (Dissenting Op. 8), and the panel decision plainly invites similar future efforts. By providing debtors and influential creditors an escape from having to respect priority rights, the panel decision encourages them to leave such creditors out in the cold. In this case, the net effect of the settlement is to permit a large secured creditor to make an end run around the priorities scheme to further its own interests. *Id.* at 5. Future parties will have the same incentive to bypass priority creditors who assert the rights Congress gave them. Such settlements "raise justifiable concerns about collusion among debtors, creditors, and their attorneys and other professionals." Op. 23.

CONCLUSION

The Court should grant the petition for rehearing en banc.

Respectfully submitted.

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